

**BNSF**

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June 23, 2004

OFFICE OF COMPLIANCE  
AND ENFORCEMENT  
STB

The Honorable Roger P. Nober  
Chairman  
Surface Transportation Board  
1925 K Street, N.W.  
Washington, DC 20423-0001

Dear Chairman Nober:

In response to your June 9 letter requesting our view of 2004's expected "Fall Peak" demands and how we expect those demands to affect BNSF and the industry, we offer the following observations, actions and goals to meet our customers' expectations. A copy of this letter will be sent to the STB Director of the Office of Compliance and Enforcement, as well as the other gentlemen copied on your letter to me.

I would like to begin by discussing our view of how we attempt to balance existing BNSF capacity, as well as our annual "expansion capital" program, against the imperfect demand forecast process used by rail customers, especially given the unprecedented rail volumes BNSF has been moving since mid-2003.

For that portion of our business that is under contract or is tied to equipment guarantee programs, we are able to plan, with fairly decent accuracy, our capacity needs. Also, based on customer input regarding future volume growth, as well as where we see our rail network coming under stress, we can identify expansion capital investments. However, there are significant financial constraints that will not allow BNSF, or any other railroad, to invest just in order to be ready to handle unforeseen, large volumes of additional or new business.

The reason is directly related to the fact that BNSF and other Class I's have had a steady erosion of their Return on Invested Capital ("ROIC") and a growing gap between this ratio and their cost of capital--a subject that has been well documented and has been a topic in some of your recent public comments. Further, revenue adequacy has been an elusive metric for several decades. For example, in the coal market, the value we receive for transporting coal has been in a steady state of decline for more than a decade. As a result, we have not been able to begin to adequately invest for the future. Based on a recent EIA forecast, there will be a 320 million ton increase in coal used for electricity in 2025, and most of it will come from the Powder River Basin ("PRB"). Thus, BNSF can expect to be asked to move another 150 million tons of coal on top of the 250 million tons we expect to haul this year. We estimate that for BNSF to handle the 2025 coal volume

forecasts from the PRB will require 210 additional train sets, 700-to-800 new AC locomotives and \$600-to-\$900 million for additional track and terminal capacity, or between \$3.2 and \$3.8 billion total.

This is in addition to the \$2.2 billion BNSF already has invested since 1994 to increasing its coal carrying capacity. Our compound annual revenue growth rate during that time was 1 percent, while our compound annual volume growth rate was 1.9 percent. We can not afford to invest for future demand when we have declining yields. This example reflects what has happened to our industry and why our industry is having difficulty dealing with the current sustained surges in demand and maintaining acceptable service metrics.

With these observations as a backdrop, let me cite actions we took late in 2003 through our capital investment program for this year to recognize the need for more capacity to deal with this unprecedented rail demand. These actions are captured in the attached letter we sent to BNSF customers on May 6, and to our short-line partners soon thereafter, to explain why our network has been fluid and should continue that way throughout the year. Please note that the 3,700 platforms being added to our stack car fleet will begin arriving July 1, and all are expected to be in service prior to Fall Peak. Further, we will have about 350 leased locomotives on property, in addition to the 350 acquired units, all in time for Fall Peak. In addition, our 2004 conductor-hiring program is progressing very well. Most of the nearly 1,800 new hires will be trained and ready to work effectively during Peak, as will most of our 17,000 other train crew personnel, as most of their vacation time will be behind them.

Other actions that we have taken include: extending train length by 10 to 15 percent, depending on type of train to create additional train slots; and managing east-bound in-gate activity at key intermodal facilities such as Hobart in Los Angeles. We also will have all of this year's major track maintenance work behind us by October 1. In each instance, we have worked with our customers to explain what we are doing, why we are doing it and what impact this will have on them. These actions are designed to keep our network fluid and ensure that we are prepared to provide the service necessary during Fall Peak to meet our customers' expectations.

We also have analyzed last year's Fall Peak volumes and compared them with our customers' demand forecasts for this year. We see about 6-to-9 percent volume growth at this time, and that equates to the volume growth rate we have been handling on our network during the second quarter of this year. We believe the key to our network's fluidity is to keep our intermodal velocity close to our plan targets, while maintaining the current improved coal cycle times, coupled with meeting our daily targets for grain, which we have been doing for a couple of months.

Even with these additions to our infrastructure and adjustments to our operating approach, it is clear to us that we do not have all the assets we could use to manage these volumes. The result is less flexibility and a severe reduction in our recoverability leverage.

Some of the critical investments that have helped us through the past year's historic volumes and will be vital to a successful Fall Peak are our Transportation Support System and our adherence to a Transportation Service Plan for every car on our railroad. Further, our steady efficiency improvements in the range of 6 percent compound annual growth rate in gross ton miles per employee has played an important role in our ability to operate our network. We need to be able to invest more vigorously in our infrastructure. We can't because our ROIC is in the 6.6 percent range and some two to three points below our cost of capital.

For 2004, because of our strong revenue growth, fuel hedging, fuel surcharge initiative, improved pricing and cost savings programs, we should see a 500 basis points improvement in our ROIC. This would be the first improvement in seven years. Unless we continue to have similar annual improvements until we get into the 9 percent ROIC range, we can not invest the capital necessary to meet future forecasted demand.

As you can see, we have been working for some time to be prepared for Fall Peak this year and in the future. The key to whether we will be successful at providing the service performance required is directly related to the level of peak volumes. This will require closer cooperation than ever before between BNSF and its customers. Our May 6 letter highlighted this point, and in all of our subsequent customer conversations, BNSF people have emphasized this issue. We look forward to participating September 9 in the customer forum sponsored by the Association of American Railroads to discuss further these issues.

There is no way to set specific performance metrics for this period, but BNSF is committed to delivering as high level of performance as is possible given the imprecision of demand forecasts and the resulting variability of equipment velocity. We will get through Peak season this year as we have every Peak. The broader question is: How can our industry, which is not revenue adequate, meet the longer-term demand of a growing U.S. economy? This is a critical question, considering current under-capacity on our highways, truck driver shortages and quality of life issues and community concerns over emissions.

The Honorable Roger P. Nober  
June 23, 2004  
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Please let me know if you have any questions, as the success of our industry in serving its customers is based on ensuring that we have a common understanding about expectations.

Sincerely,

A handwritten signature in black ink that reads "Matthew K. Rose". The signature is written in a cursive, flowing style.

Matthew K. Rose

Attachment

cc: The Honorable W. Douglas Buttrey  
The Honorable Francis Mulvey  
The Honorable Allan Rutter  
Mr. Edward R. Hamberger  
Mr. Melvin F. Clemens ✓

**BNSF**

The Burlington Northern  
and Santa Fe Railway Company

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May 6, 2004

Dear Valued BNSF Customer,

Over the past few weeks we have received inquiries from some of our customers asking about our network's vitality going forward as a result of service challenges they are experiencing with other railroads. As you may be aware, BNSF set an historic volume record during the first quarter. Therefore, we thought it is timely to share with you our thinking about network fluidity, equipment availability and crew capacity for the balance of 2004.

For the first quarter of 2004, even with our 8 percent increase in units, BNSF's car velocity was higher than last year's performance. This key measure of network fluidity has gained further momentum since April 1. As a result, we continue to be optimistic about the ability of BNSF's network to handle the unprecedented volume growth that our railroad is experiencing this year.

We will spend nearly \$2 billion in capital in 2004 to maintain our infrastructure and to add capacity to serve you. We are adding equipment such as 3,700 platforms to our stack car fleet, a 10 percent increase, giving us more than twice as many units as any other railroad; 6,000 covered hoppers at the rate of 1,500 annually through 2007 to add grain-car capacity; 390 aluminum rapid-discharge cars and 1,560 gondolas for the coal fleet; 300 72-foot refrigerated boxcars; 650 60-foot Plate F boxcars for forest-products related commodities, and 850 center-beam flatcars for lumber and building materials. We are also expanding terminal and hub capacity at locations such as Memphis, Los Angeles and San Bernardino.

We are adding nearly 350 locomotives this year. This is in addition to some 220 units on short-term leases, with 60 more scheduled to join the fleet this month. As for crews, we have already hired about 1,200 conductors this year and one-third have completed training and are on the job now. The others will finish training over the next 90 days. Overall, approximately 1,700 new train crew personnel will be hired this year.

We are proud of the hard work and dedication of Team BNSF in successfully delivering record freight volumes. Managing anticipated peak volumes this fall will require close cooperation between our teams. We need to smooth as much of the demand variability as possible to properly manage equipment, power and crews to meet our service promises to you. Let's keep the lines of communication open so we can win together.

The current economic recovery is highlighting the tremendous value that rail transportation brings to the nation's supply chain. We look forward to improving our value proposition to you as we work together to serve you and your customers. Thank you for your business and trust.

Sincerely,

John Lanigan  
Executive Vice President and  
Chief Marketing Officer

Carl Ice  
Executive Vice President and  
Chief Operations Officer